

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

**LAKE COUNTY HOUSING AND
REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

FOR THE YEAR ENDED DECEMBER 31, 2005

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for over 700 public pension funds; and

Tax Increment Financing, Investment and Finance - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**LAKE COUNTY HOUSING AND
REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

For the Year Ended December 31, 2005



**Audit Practice Division
Office of the State Auditor
State of Minnesota**

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

ORGANIZATION
DECEMBER 31, 2005

<u>Commissioners</u>	<u>Term Expires</u>
Scott Johnson	May 30, 2010
Paul Bergman	May 30, 2007
Jon Anderson	May 30, 2006
Gordon Klein	May 30, 2009

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STATE OF MINNESOTA

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PATRICIA ANDERSON
STATE AUDITOR

INDEPENDENT AUDITOR'S REPORT

Board of Commissioners
Lake County Housing and
Redevelopment Authority

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of the Lake County Housing and Redevelopment Authority, a component unit of Lake County, as of and for the year ended December 31, 2005, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Lake County Housing and Redevelopment Authority's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, and each major fund of the Lake County Housing and Redevelopment Authority as of December 31, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Lake County Housing and Redevelopment Authority has not presented a Management's Discussion and Analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 19, 2006, on our consideration of the Lake County Housing and Redevelopment Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 19, 2006

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 1

**STATEMENT OF NET ASSETS
DECEMBER 31, 2005**

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
<u>Assets</u>			
Cash	\$ 43,269	\$ 32,744	\$ 76,013
Taxes receivable	8,594	-	8,594
Accounts receivable	138,881	1	138,882
Accrued interest receivable	132	-	132
Due from Lake County	74,388	-	74,388
Internal balances	9,000	(9,000)	-
Loans receivable	83,000	-	83,000
Restricted assets			
Debt service	-	69,198	69,198
Customer deposits	-	12,860	12,860
Capital assets			
Non-depreciable	39,904	-	39,904
Depreciable - net of accumulated depreciation	960,367	1,475,890	2,436,257
Total Assets	\$ 1,357,535	\$ 1,581,693	\$ 2,939,228
<u>Liabilities</u>			
Accounts payable	\$ 5,747	\$ 6,050	\$ 11,797
Due to Lake County	698,320	-	698,320
Accrued interest payable	6,315	2,800	9,115
Deferred revenue	-	28	28
Liabilities payable from restricted assets			
Customer deposits payable	-	12,860	12,860
Long-term liabilities			
Due within one year	145,000	31,000	176,000
Due in more than one year	155,000	969,035	1,124,035
Total Liabilities	\$ 1,010,382	\$ 1,021,773	\$ 2,032,155
<u>Net Assets</u>			
Investment in capital assets - net of related debt	\$ 700,271	\$ 475,855	\$ 1,176,126
Restricted for debt service	-	69,198	69,198
Unrestricted	(353,118)	14,867	(338,251)
Total Net Assets	\$ 347,153	\$ 559,920	\$ 907,073

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2005**

	Expenses	Program Revenues Charges for Services	Net (Expense) Revenue and Changes in Net Assets		
			Governmental Activities	Business-Type Activities	Total
<u>Functions/Programs</u>					
Governmental activities					
Urban and economic development	\$ 599,718	\$ -	\$ (599,718)	\$ -	\$ (599,718)
Business-type activities					
Senior housing	163,055	141,913	-	(21,142)	(21,142)
Total	\$ 762,773	\$ 141,913	\$ (599,718)	\$ (21,142)	\$ (620,860)
General Revenues					
Tax increments			\$ 246,576	\$ -	\$ 246,576
Intergovernmental			158,585	-	158,585
Investment earnings			2,346	-	2,346
Miscellaneous			33,621	2,025	35,646
Transfers			2,738	(2,738)	-
Total general revenues			\$ 443,866	\$ (713)	\$ 443,153
Change in net assets			\$ (155,852)	\$ (21,855)	\$ (177,707)
Net Assets - Beginning			503,005	581,775	1,084,780
Net Assets - Ending			\$ 347,153	\$ 559,920	\$ 907,073

FUND FINANCIAL STATEMENTS

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GOVERNMENTAL FUND

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 3

**BALANCE SHEET
GENERAL FUND
DECEMBER 31, 2005**

Assets

Cash	\$	40,341
Undistributed cash with Lake County		2,928
Taxes receivable		8,594
Accounts receivable		138,881
Accrued interest receivable		132
Due from Lake County		74,388
Due from other funds		9,000
Loans receivable		83,000
		<hr/>
Total Assets	\$	<u><u>357,264</u></u>

Liabilities and Fund Balance

Liabilities

Accounts payable	\$	5,747
Due to Lake County		698,320
Deferred revenue		151,494
		<hr/>

Total Liabilities **\$** **855,561**

Fund Balance

Reserved for loans receivable	\$	83,000
Unreserved - undesignated		(581,297)
		<hr/>

Total Fund Balance **\$** **(498,297)**

Total Liabilities and Fund Balance **\$** **357,264**

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 4

**RECONCILIATION OF GOVERNMENTAL FUND BALANCE SHEET TO
THE GOVERNMENT-WIDE STATEMENT OF NET ASSETS--GOVERNMENTAL ACTIVITIES
DECEMBER 31, 2005**

Fund balances - governmental fund (Exhibit 3)	\$ (498,297)
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets, net of accumulated depreciation, used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	1,000,271
Other long-term assets are not available to pay for current period expenditures and, therefore, are deferred in the governmental funds.	151,494
Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported in the governmental funds.	
General Obligation Jail Lease Revenue Bonds	(300,000)
Accrued interest payable	<u>(6,315)</u>
Net assets of governmental activities (Exhibit 1)	<u>\$ 347,153</u>

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 5

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2005**

Revenues	
Tax increments	\$ 248,395
Intergovernmental	158,585
Investment earnings	2,346
Miscellaneous	
Rental income	10,819
Other	37,448
	37,448
Total Revenues	\$ 457,593
Expenditures	
Current	
Urban and economic development	
Meetings	\$ 2,942
Rental units	10,644
Legal	19,259
Consulting	2,563
Accounting and auditing	21,392
Tax increment distributions	380,706
Property maintenance and development	3,013
Other	1,774
Debt service	
Principal	140,000
Interest	18,585
	18,585
Total Expenditures	\$ 600,878
Excess of Revenues Over (Under) Expenditures	\$ (143,285)
Other Financing Sources (Uses)	
Transfer in from Silverpointe Enterprise Fund	\$ 2,738
Proceeds from sale of capital assets	70,000
	70,000
Total Other Financing Sources (Uses)	\$ 72,738
Net Change in Fund Balance	\$ (70,547)
Fund Balance - January 1	(427,750)
Fund Balance - December 31	\$ (498,297)

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 6

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE OF THE GOVERNMENTAL FUND TO THE
GOVERNMENT-WIDE STATEMENT OF ACTIVITIES--GOVERNMENTAL ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2005**

Net change in fund balances - governmental fund (Exhibit 5) \$ (70,547)

Amounts reported for governmental activities in the statement of activities are different because:

In the funds, under the modified accrual basis, receivables not available for expenditure are deferred. In the statement of activities, those revenues are recognized when earned. The adjustment to revenues between the fund statements and the statement of activities is the increase (decrease) in revenues deferred as unavailable.

Deferred revenue - December 31	\$ 151,494	
Deferred revenue - January 1	<u>(167,959)</u>	(16,465)

Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Current year depreciation		(31,670)
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In the statement of activities, only the gain or loss on the disposal of capital assets is reported; whereas, in the fund financial statements, the proceeds from the disposal increase financial resources. Therefore, the change in net assets differs from the change in fund balance by the book value of the capital assets disposed of.

(180,028)

Repayment of debt principal is an expenditure in the governmental fund, but the repayment reduces long-term debt at the government-wide level.

Principal repayments		140,000
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Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.

Change in accrued interest payable		<u>2,858</u>
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Change in net assets of governmental activities (Exhibit 2) \$ (155,852)

PROPRIETARY FUND

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 7

**STATEMENT OF NET ASSETS
SILVERPOINTE ENTERPRISE FUND
DECEMBER 31, 2005**

Assets

Current assets

Cash and cash equivalents	\$	32,744
Accounts receivable		1

Total current assets	\$	32,745
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Restricted assets

Cash		
Debt service	\$	69,198
Customer deposits		12,860

Total restricted assets	\$	82,058
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Noncurrent assets

Capital assets		
Depreciable capital assets - net of accumulated depreciation	\$	1,475,890

Total Assets	\$	1,590,693
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Liabilities

Current liabilities

Accounts payable	\$	6,050
Interest payable		2,800
Due to other funds		9,000
Deferred revenue		28
General obligation bonds payable - current		31,000

Total current liabilities	\$	48,878
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Current liabilities payable from restricted assets

Customer deposits payable	\$	12,860
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Noncurrent liabilities

General obligation bonds payable - long-term	\$	969,035
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Total Liabilities	\$	1,030,773
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Net Assets

Invested in capital assets - net of related debt	\$	475,855
Restricted for debt service		69,198
Unrestricted		14,867

Total Net Assets	\$	559,920
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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 8

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
SILVERPOINTE ENTERPRISE FUND
FOR THE YEAR ENDED DECEMBER 31, 2005**

Operating Revenues	
Rental	\$ 136,888
Parking	5,025
Miscellaneous	2,025
	<hr/>
Total Operating Revenues	\$ 143,938
Operating Expenses	
Other services and charges	
Human resources	\$ 15,564
Management fees	8,218
Professional fees	2,785
Real estate taxes	6,900
Travel	419
Telephone	2,374
Utilities	17,707
Advertising	6,763
Insurance	4,600
Repairs and maintenance	6,471
Sanitation	1,839
Miscellaneous	308
Supplies	1,709
Depreciation expense	46,978
	<hr/>
Total Operating Expenses	\$ 122,635
Operating Income (Loss)	\$ 21,303
Nonoperating Revenues (Expenses)	
Interest expense	(40,420)
	<hr/>
Income (Loss) Before Transfers	\$ (19,117)
Transfers to General Fund	(2,738)
	<hr/>
Change in Net Assets	\$ (21,855)
Net Assets - January 1	581,775
	<hr/>
Net Assets - December 31	\$ 559,920
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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

EXHIBIT 9

**STATEMENT OF CASH FLOWS
SILVERPOINTE ENTERPRISE FUND
YEAR ENDED DECEMBER 31, 2005**

Cash Flows from Operating Activities	
Cash received from customers	\$ 143,940
Cash paid to suppliers	<u>(79,586)</u>
Net cash provided by (used for) operating activities	<u>\$ 64,354</u>
Cash Flows from Noncapital Financing Activities	
Transfers out to General Fund	<u>\$ (2,738)</u>
Cash Flows from Capital and Related Financing Activities	
Principal paid on long-term debt	\$ (28,927)
Interest paid on long-term debt	<u>(40,270)</u>
Net cash provided by (used for) capital and related financing activities	<u>\$ (69,197)</u>
Net Increase (Decrease) in Cash	\$ (7,581)
Cash and Cash Equivalents - January 1, 2005	<u>40,325</u>
Cash and Cash Equivalents - December 31, 2005	<u><u>\$ 32,744</u></u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used for) Operating Activities	
Net operating income (loss)	\$ 21,303
Adjustments to reconcile net operating income (loss) to net cash provided by (used for) operating activities	
Depreciation expense	46,978
(Increase) decrease in accounts receivable	(1)
Increase (decrease) in accounts payable	1,451
Increase (decrease) in interfund payable	(5,380)
Increase (decrease) in deferred revenue	<u>3</u>
Net Cash Provided by (Used for) Operating Activities	<u><u>\$ 64,354</u></u>
Noncash Investing, Capital, and Financing Activities	
Increase in cash held for security deposits	\$ 3,241

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

**NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2005**

1. Summary of Significant Accounting Policies

The Lake County Housing and Redevelopment Authority's financial statements are prepared in accordance with generally accepted accounting principles (GAAP) for the year ended December 31, 2005. The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (statements and interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989, (when applicable) that do not conflict with or contradict GASB pronouncements. Although the Authority has the option to apply FASB pronouncements issued after that date to its business-type activities and enterprise funds, the Authority has chosen not to do so. The Authority has not presented in the financial statements a Management's Discussion and Analysis that GASB has determined is necessary to supplement, although not required to be part of, the basic financial statements. The more significant accounting policies established in GAAP and used by the Authority are discussed below.

A. Financial Reporting Entity

The Lake County Housing and Redevelopment Authority was established June 13, 1984, and became active in 1986, having all the powers and duties of a county housing and redevelopment authority under the provisions of Minn. Stat. §§ 469.001-469.047. The Authority is governed by a five-member Board, appointed by the Lake County Board of Commissioners. The Board is organized with a chair, vice chair, and a secretary-treasurer, elected annually. At December 31, 2005, there are four Board members and one vacancy.

Component Unit

The Lake County Housing and Redevelopment Authority is considered to be a component unit of Lake County and is included in Lake County's annual financial report.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

B. Basic Financial Statements

1. Government-Wide Statements

The government-wide financial statements (the statement of net assets and the statement of activities) display information about the government. These statements include the financial activities of the overall Authority government. Eliminations have been made to minimize the double counting of internal activities. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges to external parties for support.

In the government-wide statement of net assets, both the governmental and business-type activities columns: (a) are presented on a consolidated basis by column; and (b) are reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations.

The Authority's net assets are reported in three parts: (1) invested in capital assets, net of related debt; (2) restricted net assets; and (3) unrestricted net assets.

The statement of activities demonstrates the degree to which the direct expenses of each function of the Authority's governmental activities and business-type activities are offset by program revenues. Direct expenses are those clearly identifiable with a specific function or activity. Program revenues include: (1) fees, fines, and charges paid by the recipients of goods, services, or privileges provided by a given function or activity; and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or activity. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

2. Fund Financial Statements

The fund financial statements provide information about the Authority's funds. Separate statements for each fund--governmental and proprietary--are presented.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basic Financial Statements

2. Fund Financial Statements (Continued)

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or incidental activities.

The Authority reports the following major governmental fund:

The General Fund is the Authority's primary operating fund. It accounts for all financial resources of the general government not accounted for in other funds.

The Authority reports the following major enterprise fund:

The Silverpointe Enterprise Fund is used to account for the operations of a 25-unit senior housing facility in Silver Bay, Minnesota. The facility is owned by the Authority and was built to provide quality and affordable housing for senior citizens in Lake County. Silverpointe is operated similar to a business enterprise. The intent of the Authority is that the cost of providing housing services to the general public, on a continuing basis, is financed or recovered primarily through user charges.

C. Measurement Focus and Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

C. Measurement Focus and Basis of Accounting (Continued)

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Lake County Housing and Redevelopment Authority considers all revenues to be available if they are collected within 90 days after the end of the current period. Property and other taxes, licenses, and interest are all considered to be susceptible to accrual.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, and claims and judgments, which are recognized as expenditures to the extent that they have matured. Proceeds of general long-term debt and acquisitions under capital leases are reported as other financing sources.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Budget

The Authority does not prepare budgets for the General Fund operations. Expenditures are made in accordance with the tax increment financing plans for the tax increment financing districts. An estimated operating budget is prepared by the management company for the Silverpointe Enterprise Fund. The budget is prepared on an accrual basis. The budget is approved and can be adjusted by the Board.

E. Assets, Liabilities, and Net Assets or Equity

1. Cash and Cash Equivalents

The Authority's cash and cash equivalents consist of savings and checking accounts, cash on hand, and certificates of deposit, and do not include restricted accounts.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

E. Assets, Liabilities, and Net Assets or Equity (Continued)

2. Receivables and Payables

All outstanding balances between funds are reported as “due to/from other funds.” Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances.”

Property taxes, including property taxes captured as tax increments, are levied as of January 1 on property values assessed as of the same date. The tax levy notice is mailed in March with the first half payment due on May 15 and the second half payment due October 15. The Authority approved an annual levy for operating purposes. Property taxes, including tax increment, are collected by Lake County.

Unpaid taxes at December 31 become liens on the respective property and are classified in the financial statements as taxes receivable.

3. Restricted Assets

Certain funds of the Authority are classified as restricted assets on the statement of net assets because the restriction is either imposed by law through constitutional provisions or enabling legislation or imposed externally by creditors, grantors, contributors, or laws or regulations of other governments. Therefore, their use is limited by applicable laws and regulations.

4. Capital Assets

Capital assets, which include land, buildings and structures, and equipment, are reported in the applicable governmental or business-type activities column in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$1,000 and have an expected life of at least five years. Such assets are recorded at historical cost.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets’ lives are not capitalized.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

1. Summary of Significant Accounting Policies

E. Assets, Liabilities, and Net Assets or Equity

4. Capital Assets (Continued)

Buildings and structures and equipment of the Authority is depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Buildings and structures	25 - 40
Equipment	7

5. Deferred Revenue

All funds and the government-wide financial statements defer revenue for resources that have been received, but not yet earned. Governmental funds also report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period.

6. Long-Term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets.

7. Fund Equity

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose.

8. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits

The Authority's total deposits are reported as follows:

Government-wide statement of net assets		
Governmental activities		
Cash	\$	43,269
Business-type activities		
Cash		32,744
Restricted assets		
Debt service		69,198
Customer deposits		<u>12,860</u>
 Total Cash	 \$	 <u><u>158,071</u></u>

Minn. Stat. §§ 118A.02 and 118A.04 authorize the Authority to designate a depository for public funds and to invest in certificates of deposit. Minn. Stat. § 118A.03 requires that all Authority deposits be protected by insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit plus accrued interest at the close of the financial institution's banking day, not covered by insurance or bonds.

Authorized collateral includes treasury bills, notes, and bonds; issues of U.S. government agencies; general obligations rated "A" or better and revenue obligations rated "AA" or better; irrevocable standard letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution that is not owned or controlled by the financial institution furnishing the collateral.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

a. Deposits (Continued)

Custodial Credit Risk

Custodial credit risk is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2005, \$35,612 of the Authority's book balance of \$158,071 was exposed to custodial credit risk. These deposits are held in a trust account by the property manager of the Authority's rental units. The trust accounts are in the property manager's name and hold funds for multiple properties managed by the company. The account balances of each property are tracked internally by the property manager. Although the accounts are covered by FDIC insurance, it is not possible to determine the amount of FDIC coverage which is available to cover each property's individual balance.

Uninsured and uncollateralized	<u>\$35,612</u>
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b. Investments

Minn. Stat. §§ 118A.04 and 118A.05 generally authorize the following types of investments as available to the Authority:

- (1) securities which are direct obligations or are guaranteed or insured issues of the United States, its agencies, its instrumentalities, or organizations created by an act of Congress, except mortgage-backed securities defined as "high risk" by Minn. Stat. § 118A.04, subd. 6;
- (2) mutual funds through shares of registered investment companies provided the mutual fund receives certain ratings depending on its investments;

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

- (3) general obligations of the State of Minnesota and its municipalities, and in certain state agency and local obligations of Minnesota and other states provided such obligations have certain specified bond ratings by a national bond rating service;
- (4) bankers' acceptances of United States banks;
- (5) commercial paper issued by United States corporations or their Canadian subsidiaries that is rated in the highest quality category by two nationally recognized rating agencies and matures in 270 days or less; and
- (6) with certain restrictions, in repurchase agreements, securities lending agreements, joint powers investment trusts, and guaranteed investment contracts.

Interest Rate Risk

Interest rate risk is the risk that changes in the market interest rates will adversely affect the fair value of an investment.

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

1. Deposits and Investments

b. Investments (Continued)

Custodial Credit Risk

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

Concentration of Credit Risk

The concentration of credit risk is the risk of loss that may be caused by the Authority's investment in a single issuer.

As of and during the year ended, December 31, 2005, the Authority did not own any investments that required disclosure regarding interest rate risk, credit risk, custodial credit risk, or concentration of credit risk.

2. Receivables

Receivables as of December 31, 2005, for the Authority's governmental activities are as follows:

	Total Receivables	Amounts Not Scheduled for Collection During the Subsequent Year
Governmental Activities		
Taxes	\$ 8,594	\$ -
Accounts receivable	138,881	-
Accrued interest	132	-
Due from Lake County	74,388	-
Loans receivable	83,000	27,000
Total Governmental Activities	\$ 304,995	\$ 27,000

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets (Continued)

3. Loan Receivable

The Authority has an \$83,000 loan receivable from North Shore Business Enterprise Center, Inc., an unrelated nonprofit organization. The loan is without interest. Annual principal payments are scheduled of \$28,000 due on September 1, 2005, \$28,000 due on September 1, 2006, and the final payment of \$27,000 due on September 1, 2007. The payment, which was due in 2005, has not been paid.

4. Capital Assets

Capital asset activity for the year ended December 31, 2005, was as follows:

Governmental Activities

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets not depreciated				
Land	\$ 208,629	\$ 11,303	\$ 180,028	\$ 39,904
Capital assets depreciated				
Buildings and structures	\$ 1,250,973	\$ -	\$ 11,303	\$ 1,239,670
Less: accumulated depreciation for Buildings and structures	<u>247,633</u>	<u>31,670</u>	<u>-</u>	<u>279,303</u>
Total capital assets depreciated, net	<u>\$ 1,003,340</u>	<u>\$ (31,670)</u>	<u>\$ 11,303</u>	<u>\$ 960,367</u>
Governmental Activities Capital Assets, Net	<u>\$ 1,211,969</u>	<u>\$ (20,367)</u>	<u>\$ 191,331</u>	<u>\$ 1,000,271</u>

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

A. Assets

4. Capital Assets (Continued)

Business-Type Activities

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets depreciated				
Buildings and structures	\$ 1,879,117	\$ -	\$ -	\$ 1,879,117
Equipment	3,911	-	-	3,911
Total capital assets depreciated	\$ 1,883,028	\$ -	\$ -	\$ 1,883,028
Less: accumulated depreciation for				
Buildings and structures	\$ 356,249	\$ 46,978	\$ -	\$ 403,227
Equipment	3,911	-	-	3,911
Total accumulated depreciation	\$ 360,160	\$ 46,978	\$ -	\$ 407,138
Business-Type Activities Capital Assets, Net	\$ 1,522,868	\$ (46,978)	\$ -	\$ 1,475,890

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental Activities	
Urban and economic development	\$ 31,670
Business-Type Activities	
Senior housing	\$ 46,978

B. Interfund Receivables, Payables, and Transfers

The composition of interfund balances as of December 31, 2005, is as follows:

1. Due To/From Other Funds

Receivable Fund	Payable Fund	Amount
General Fund	Silverpointe Enterprise Fund	\$ 9,000

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

B. Interfund Receivables, Payables, and Transfers

1. Due To/From Other Funds (Continued)

The General Fund pays for insurance expense. A portion of the expense is then reimbursed by the Silverpointe Enterprise Fund. The amount payable at year-end is the insurance allocation for the years 2004 and 2005.

2. Transfers To/From Other Funds

Receiving Fund	Paying Fund	Amount
General Fund	Silverpointe Enterprise Fund	\$ 2,738

An unused bank account was closed out in the Silverpointe Enterprise Fund and transferred to the General Fund.

C. Liabilities

1. Long-Term Debt

Governmental Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rates (%)	Original Issue Amount	Outstanding Balance December 31, 2005
1996 General Obligation Jail Lease Revenue Bonds	2007	\$95,000- \$155,000	4.00 to 5.10	\$ 1,245,000	\$ 300,000

Business-Type Activities

Type of Indebtedness	Final Maturity	Installment Amounts	Interest Rates (%)	Original Issue Amount	Outstanding Balance December 31, 2005
1996 General Obligation Senior Housing Bonds	2027	Varies	3.92	\$ 1,160,642	\$ 1,000,035

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities (Continued)

2. Debt Service Requirements

Debt service requirements at December 31, 2005, were as follows:

Governmental Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2006	\$ 145,000	\$ 11,530
2007	155,000	3,953
Total	<u>\$ 300,000</u>	<u>\$ 15,483</u>

Business-Type Activities

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2006	\$ 31,000	\$ 38,165
2007	31,780	37,418
2008	33,048	36,150
2009	34,367	34,831
2010	35,739	33,459
2011 - 2015	201,264	144,725
2016 - 2020	244,765	101,224
2021 - 2025	297,668	48,321
2026 - 2027	90,404	2,548
Total	<u>\$ 1,000,035</u>	<u>\$ 476,841</u>

3. Changes in Long-Term Liabilities

Governmental Activities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable					
General Obligation Jail					
Lease Revenue Bonds	\$ 440,000	\$ -	\$ 140,000	\$ 300,000	\$ 145,000

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

2. Detailed Notes on All Funds

C. Liabilities

3. Changes in Long-Term Liabilities (Continued)

Business-Type Activities

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Bonds payable					
General Obligation					
Senior Housing Bonds	\$ 1,028,962	\$ -	\$ 28,927	\$ 1,000,035	\$ 31,000

3. Summary of Significant Contingencies and Other Items

A. Tax Increment Financing Districts

The Authority administers the following tax increment financing districts established pursuant to Minn. Stat. §§ 469.174 - 469.1791.

District Number 2	Blue Water/Superior Shores Project
District Number 3	Cove Point Project
District Number 4	Incubator Building Project

The bonds outstanding for District Nos. 2 and 3 are general obligation bonds issued by Lake County and are included in the Lake County financial statements. The bonds do not constitute a debt of the Authority. The County collects and pays the debt service payments pursuant to the amended Tax Increment Pledge Agreement, and the Authority recognizes the tax increment revenues and tax increment distributions to Lake County in its financial statements.

B. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; or natural disasters. To manage these risks, the Authority has joined the Minnesota Counties Insurance Trust (MCIT). The Authority retains risk for the deductible portions of the insurance policies. The amounts of these deductibles are considered immaterial to the financial statements. There were no significant reductions in insurance from the prior year. The amount of settlements did not exceed insurance coverage for the past three fiscal years.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

3. Summary of Significant Contingencies and Other Items (Continued)

C. Related Party Transactions - Lake County

The Lake County Housing and Redevelopment Authority is a discretely presented component unit of Lake County. During 1996, the Authority issued \$1,245,000 in General Obligation Jail Lease Revenue Bonds, which have \$300,000 outstanding at December 31, 2005. The bonds were issued to finance the jail portion of the County Law Enforcement Center. The jail is owned by the Authority and is leased to Lake County. The County makes lease payments in the amounts necessary to make the bond principal and interest payments each year. When all of the bonds have been paid off, the title to the jail will pass to the County. Because the debt is essentially an obligation of the County, it is shown as County debt in the Lake County financial statements. It is also shown as debt in the separately issued financial statements of the Lake County Housing and Redevelopment Authority because the Authority issued the bonds.

D. Tax Increment Assistance

The Lake County Housing and Redevelopment Authority is committed to provide tax increment assistance pursuant to the Northshore Business Enterprise Center development agreement. The assistance is provided in the form of an annual tax rebate to the developer. The annual tax rebate is contingent upon payment of annual property taxes by the developer. The assistance for the project is limited in amount based on both the scope of the project and the life of the tax increment district. The tax increment assistance does not result in debt proceeds and does not meet the definition of debt.

E. Conduit Debt Obligation

The Lake County Housing and Redevelopment Authority has issued the Health Care Facilities Revenue Bonds, Series 2000, originally issued for \$5,000,000 in May 2000, and refinanced in October 2003 for \$4,108,000, to provide financial assistance to First Plan of Minnesota to construct two medical clinics. The bonds are secured by the property financed through a loan agreement and are payable solely from the revenues of First Plan of Minnesota. Neither the Authority nor the state is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as a liability in the accompanying financial statements.

**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

3. Summary of Significant Contingencies and Other Items (Continued)

F. Financial Condition

The Authority's expenses, including required payments to Lake County pursuant to bond obligations, exceed current tax increment financing and other revenues. This continuing condition has resulted in a deficit balance of unrestricted net assets. Under current agreements and regulations, it appears the financial condition of the Authority will continue to deteriorate. The Authority's Board is looking into ways to improve its financial condition, including working with other similarly situated parties and the Minnesota Legislature to amend tax increment laws. The Authority is also in discussion with Lake County regarding its current obligations and the availability of alternative revenue sources.

The ability of the Authority to continue as a going concern is dependent on its ability to generate additional revenues and/or limit its current debt obligations to provide sufficient net cash flow to fund its daily and long-term obligations. The financial statements do not include any adjustments that might be necessary if the Authority is unable to continue as a going concern.

G. Subsequent Events

In June 2005, the Authority passed a resolution authorizing the Authority to enter into an agreement to purchase 70 acres of land from Lake County for the amount of \$250,000. The property will be used for a housing development to meet the County's housing needs and to assist in fostering economic development in the County.

The purchase price of \$250,000 will be paid to the County as individual lots are sold in the development. This agreement is expected to be completed in 2006.

In April 2006, the Authority authorized the sale of the Two Harbors duplex rental property to Lake County for \$88,000.

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**LAKE COUNTY HOUSING AND REDEVELOPMENT AUTHORITY
TWO HARBORS, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2005**

I. FINANCIAL STATEMENT AUDIT--INTERNAL CONTROLS

PREVIOUSLY REPORTED ITEM NOT RESOLVED

98-1 Segregation of Duties

The Lake County Housing and Redevelopment Authority has no employees, and operations are handled by the contracted attorney, a consultant, a contracted rental manager, and Board members. These operations are reported to the Board by the contracted accounting firm. The Authority does not have segregation of accounting functions necessary to ensure adequate internal accounting control. This is not unusual in operations the size of the Authority.

We recommend that management be aware of this condition.

Client's Response:

The LCHRA is aware that this continues to be a problem and will make all efforts possible to maintain internal accounting control.

II. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEM NOT RESOLVED

03-1 Financial Condition

The Authority's financial statements are prepared based on the assumption that the Authority will continue as a going concern in the future. As a result of the Authority's current financial condition, it is questionable how long the Authority will continue to be a going concern because of its inability to meet its obligations as they become due.

The General Fund's fund balance has steadily decreased from a positive \$829,048 at December 31, 1997, to a negative \$498,297 at December 31, 2005. This is a result of tax increment revenues decreasing from \$501,092 in 1998 to \$248,395 in 2005. Class rate changes and the fiscal disparity tax have decreased the amount of tax increments collected. Future tax increment collections will likely not be sufficient to fund future debt service.

We recommend the Authority develop a formal plan that would outline how the Authority intends to improve its current financial condition. The Authority may wish to consider liquidating certain assets, restructuring existing debt, reducing expenditures, and obtaining other sources of revenue.

Client's Response:

The LCHRA understands that in spite of its ability to reduce operational costs during 2005 and collect some funds owed to the LCHRA, the financial situation continues to be one of diminishing cash flow.

Plans for 2006-2007:

- 1. Continue to bill and collect funds owed to the LCHRA.*
- 2. Continue to work with Bowman Properties to increase the financial stability of Silverpointe.*
- 3. Reduce monthly expenses: cut down accounting fees, meeting costs, attorney fees, and decrease the frequency of meetings.*
- 4. Proceed with development/sale of the Segog property.*
- 5. Establish an Agreement with First Plan to facilitate payment to the LCHRA of the Issuer Fee of one-tenth of one percent of the outstanding principal amount of the amended bond on October 10, 2003, and each anniversary date thereafter until the amended bond has been paid in full. The Healthcare Facilities Revenue Bond was for \$4,108,000.*

PREVIOUSLY REPORTED ITEM RESOLVED

Development Agreement Billing (98-2)

The Authority has a development agreement that includes a tax increment financing guarantee on the Cove Point project. The agreement guarantees a minimum amount of tax increments to be collected on the project. Any deficiency of tax increments collected under the guarantee is to be paid to the Authority by the developer. The tax increments collected on the property have not met the guarantee in any year since 1997. In our prior audit, we noted that the deficient amounts for the years 1998 to 2004 that had not been billed to the developer by the Authority totaled \$118,851 at December 31, 2004. We recommended that the Authority review the development agreement to ascertain that billings are being prepared and collected on a timely basis.

Resolution

The Authority billed the Cove Point developer \$118,851 in 2006. There was no additional amount to be billed for the year ended December 31, 2005. The developer has agreed to begin paying back the balance over a period of time.



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PATRICIA ANDERSON
STATE AUDITOR

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Board of Commissioners
Lake County Housing and
Redevelopment Authority

We have audited the financial statements of the Lake County Housing and Redevelopment Authority as of and for the year ended December 31, 2005, and have issued our report thereon dated May 19, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Lake County Housing and Redevelopment Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Authority's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the accompanying Schedule of Findings and Recommendations as item 98-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the

internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable condition indicated above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Lake County Housing and Redevelopment Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories, except that we did not test for compliance in contracting and bidding, because the Lake County Housing and Redevelopment Authority did not enter into any applicable contracts.

The results of our tests indicate that, for the items tested, the Lake County Housing and Redevelopment Authority complied with the material terms and conditions of applicable legal provisions.

This report is intended solely for the information and use of the Board of Commissioners and management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: May 19, 2006